



AUDITOR - GENERAL
SOUTH AFRICA

The accounting officer
Nkomazi Local Municipality
Private Bag X101
Malelane
1320

Date: 03 December 2012

Reference: 07464REG11-12

Dear Mr. MD Ngwenya

Report of the Auditor-General on the financial statements and other legal and regulatory requirements of Nkomazi Local Municipality for the year ended 30 June 2012

1. The above-mentioned report of the Auditor-General is submitted herewith in terms of section 21(1) of the Public Audit Act of South Africa read in conjunction with section 188 of the Constitution of the Republic of South Africa section 121(3) of the Municipal Finance Management Act of South Africa (MFMA)
2. We have not yet received the other information that will be included in the annual report with the audited financial statements and have thus not been able to establish whether there are any inconsistencies between this information and the audited financial statements and the reported performance against pre-determined objectives. You are requested to supply this information as soon as possible. Once this information is received it will be read and should any inconsistencies be identified these will be communicated to you and you will be requested to make the necessary corrections. Should the corrections not be made we will amend and reissue the audit report.
3. In terms of section 121(3) of the MFMA you are required to include the audit report in the municipality's annual report to be tabled.
4. Until the annual report is tabled as required by section 127(2) of the MFMA the audit report is not a public document and should therefore be treated as confidential.
5. Prior to printing or copying the annual report which will include the audit report you are required to do the following:
 - Submit the final printer's proof of the annual report to the relevant senior manager of the Auditor-General of South Africa for verification of the audit-related references in the audit report and for confirmation that the financial statements and other information are those documents that have been read and audited. Special care should be taken with the page references in your report, since an incorrect reference could have audit implications.

- The signature *Auditor-General* in the handwriting of the auditor authorised to sign the audit report at the end of the hard copy of the audit report should be scanned in when preparing to print the report. This signature, as well as the place and date of signing and the Auditor-General of South Africa's logo, should appear at the end of the report, as in the hard copy that is provided to you. The official logo will be made available to you in electronic format.
6. Please notify the undersigned Business Executive well in advance of the date on which the annual report containing this audit report will be tabled.
 7. Your cooperation to ensure that all these requirements are met would be much appreciated.

Kindly acknowledge receipt of this letter.

Yours sincerely

Signed

A handwritten signature in black ink, appearing to read 'Sibongile Lubambo', is written over a circular stamp that contains several vertical lines.

.....
Deputy Business Executive: Mpumalanga

Enquiries: Sibongile Lubambo
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REPORT OF THE AUDITOR-GENERAL TO THE MPUMALANGA PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE NKOMAZI LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the financial statements of the Nkomazi Local Municipality, which comprise the statement of financial position as at 30 June 2012, the statements of financial performance, changes in net assets and cash flows for the year then ended, a summary of significant accounting policies and other explanatory information, and the accounting officer's report as set out on pages ... to

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the Statements of Generally Recognised Accounting Practice (GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2011 (Act No. 6 of 2011) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Cash and cash equivalents

4. Cash and cash equivalents from the municipal infrastructure grant (MIG) account of R17 506 057 (2011: R9 945 961) were disclosed in note 9 to the financial statements. The municipality could not provide supporting evidence for the difference of R11 057 620 between the cash book balance as per the general ledger and the cash book balance per the bank reconciliation statement. Furthermore, the bank reconciliation statement consists of reconciling items of R3 654 867 debit and R11 112 513 credit that were not supported by documentary evidence. Consequently, I was unable to confirm the valuation and completeness of cash and cash equivalents. The municipality's records did not permit the application of alternative procedures.

5. I was unable to confirm the validity and accuracy of the adjustments to the value of R108 885 435 debit and R82 847 480 credit made to the above-mentioned bank reconciliation statement, as adequate supporting evidence could not be provided. Consequently, I was unable to determine whether any adjustments relating to the bank reconciliation statements were necessary.
6. The bank overdraft of R16 024 667 (2011: R12 986 347) from the operational account was disclosed in note 9 to the financial statements. The municipality could not provide supporting evidence for the difference of R6 599 847 between the cash book balance per the general ledger and the cash book balance per the bank reconciliation statement. Furthermore, the bank reconciliation statement consists of reconciling items of R24 212 326 debit and R7 282 224 credit that were not supported by documentary evidence. Consequently, I was unable to confirm the valuation and completeness of cash and cash equivalents. The municipality's records did not permit the application of alternative procedures.
7. I was unable to confirm the validity and accuracy of the adjustments to the value of R491 122 801 debit and R530 756 481 credit made to the above-mentioned bank reconciliation statement, as supporting evidence could not be provided. Consequently, I was unable to determine whether any adjustments relating to the bank reconciliation statements were necessary.

Property, plant and equipment

8. I was unable to obtain sufficient appropriate audit evidence to confirm the completeness of infrastructure assets, stated at R679 037 215 in the financial statements. I was unable to confirm the completeness of these assets by alternative means. Consequently, I was unable to determine whether any adjustment relating to immovable assets in the financial statements was necessary.
9. I was unable to obtain sufficient appropriate audit evidence to confirm the existence of plant and equipment, stated at R10 791 953 in the financial statements. I was unable to confirm the existence of these assets by alternative means. Consequently, I was unable to determine whether any adjustment relating to movable assets in the financial statements was necessary.

Distribution losses

10. Section 125(2)(d)(i) of the MFMA states that the notes to the annual financial statements of a municipality must disclose particulars of any material losses. The municipality did not disclose distribution losses with regard to water, as the municipality had not implemented adequate control measures to reliably calculate these losses. I was unable to determine the total extent of the understatement of distribution losses, as sufficient appropriate audit evidence could not be obtained.

Aggregation of immaterial uncorrected misstatements

11. I was unable to obtain sufficient appropriate audit evidence for journals, expenditure vouchers as well as physical assets, and confirm or verify the following elements by alternative means:

- Accumulated surplus reflected as R1 948 433
- Expenditure reflected as R699 666

As a result, I was unable to determine whether any adjustments to these elements were necessary.

Disclaimer of opinion

12. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

Emphasis of matters

13. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

14. As disclosed in note 44 to the financial statements, the corresponding figures for 30 June 2011 have been restated as a result of an error discovered during 2012 in the financial statements of the municipality at, and for the year ended, 30 June 2011.

Material losses

15. The municipality suffered a significant electricity loss of 32 080 855 units with a value of R26 383 931 during the year under review.
16. Material losses to the amount of R3 418 215 were reported by the municipality as a result of the write-off of irrecoverable debt.

Material impairments

17. As disclosed in note 8 to the financial statements, material impairments of R14 199 512 were incurred as a result of the provision for doubtful debts.

Additional matter

18. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited supplementary information

19. The supplementary information set out on pages ... to ... does not form part of the financial statements and is presented as additional information. I have not audited this schedule and, accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

20. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

21. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.

22. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned development priorities. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury's *Framework for managing programme performance information (FMPPI)*.

23. The reliability of the information in respect of the selected development priorities is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

24. The material findings are as follows:

Usefulness of information

Presentation

25. Improvement measures in the annual performance report for 57% of the planned targets not achieved were not disclosed, as required by section 46 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA). This was due to inadequate internal policies and procedures over the processes pertaining to the reporting of performance information.

Consistency

26. Section 41(c) of the MSA requires that the integrated development plan should form the basis for the annual report, therefore requiring the consistency of objectives, indicators and targets between planning and reporting documents. 90% of the reported objectives were not consistent with the objectives as per the approved integrated development plan. This was due to a lack of adequate review and application of the FMPPI.
27. Section 41(c) of the MSA requires that the integrated development plan should form the basis for the annual report, therefore requiring the consistency of objectives, indicators and targets between planning and reporting documents. 96% of the reported indicators were not consistent with the objectives as per the approved integrated development plan. This was due to a lack of adequate review and application of the FMPPI.

Measurability

28. The FMPPI requires that indicators should have clear, unambiguous data definitions so that data can be collected consistently and is easy to understand and use. 95% of the targets relevant to infrastructure development and community services were not specific in clearly identifying the nature and the required level of performance. This was due to the fact that management was aware of the requirements of the FMPPI but had not received the necessary training to enable application of the principles.
29. The FMPPI requires that indicators should have clear, unambiguous data definitions so that data can be collected consistently and is easy to understand and use. The required performance could not be measured for 100% of the targets relevant to infrastructure development and community services. This was due to the fact that management was aware of the requirements of the FMPPI but had not received the necessary training to enable application of the principles.
30. The FMPPI requires that indicators should have clear, unambiguous data definitions so that data can be collected consistently and is easy to understand and use. 95% of the targets relevant to infrastructure development and community services were not time bound in specifying a time period or deadline for delivery. This was due to the fact that management was aware of the requirements of the FMPPI but had not received the necessary training to enable application of the principles.
31. The FMPPI requires that indicators should have clear, unambiguous data definitions so that data can be collected consistently and is easy to understand and use. None (100%) of the indicators relevant to infrastructure development and community services were well defined in that clear, unambiguous data definitions were available to allow for data to be collected consistently. This was due to the fact that management was aware of the requirements of the FMPPI but had not received the necessary training to enable application of the principles.
32. The FMPPI requires that indicators should have clear, unambiguous data definitions so that data can be collected consistently and is easy to understand and use. None (100%) of the indicators relevant to infrastructure development and community services were verifiable in that valid processes and systems that produced the information on actual performance did not exist. This was due to the fact that management was aware of the requirements of the FMPPI but had not received the necessary training to enable application of the principles.

Reliability of information

Validity

33. The FMPPI requires that processes and systems that produce the indicator should be verifiable. All (100%) of the actual reported performance relevant to the selected development objectives differed materially when compared to the source information provided. This was due to a lack of standard operating procedures for the recording of actual achievements by senior management.

Accuracy

34. The FMPPI requires that the indicator be accurate enough for its intended use and respond to changes in the level of performance. None (100%) of the actual reported indicators relevant to infrastructure development and community services were accurate when compared to source information. This was due to a lack of standard operating procedures for the recording of actual achievements by senior management.

Completeness

35. The FMPPI requires that documentation addressing the systems and processes for identifying, collecting, collating, verifying and storing information be properly maintained. Source information for 80% of the actual reported performance was not completely recorded for the selected development objectives. This was due to an improper document management system with regard to actual performance achievements.

Additional matter

36. I draw attention to the matter below. This matter does not have an impact on the audit findings on predetermined objectives reported above.

Achievement of planned targets

37. Of the total number of 78 planned targets, 41 were achieved during the year under review. This means that 47% of the total planned targets were not achieved during the year under review. This was mainly due to the fact that indicators and targets were not suitably developed during the strategic planning process.

Compliance with laws and regulations

38. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the general notice issued in terms of the PAA are as follows:

Annual financial statements, performance report and annual report

39. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current assets, current liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a disclaimer of audit opinion.
40. The annual performance report for the year under review did not include measures taken to improve performance, as required by section 46(1)(a), (b) and (c) of the MSA.

Asset and liability management

41. An adequate management, accounting and information system was not in place to account for assets, as required by section 63(2)(a) of the MFMA.
42. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.
43. All investments were not made in accordance with the requirements of the investment policy, as three quotations were not obtained from the financial institutions, as required by Municipal Investment Regulation 3(3).

Audit committee

44. A performance audit committee was not in place and the audit committee established in terms of section 166(1) of the MFMA was not used for this function, as required by Municipal Planning and Performance Management Regulation 14(2)(a).

Budgets

45. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

Expenditure management

46. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
47. Payments were made without the approval of the accounting officer or a properly authorised official, as required by section 11(1) of the MFMA.
48. An adequate management, accounting and information system was not in place to recognise expenditure when it was incurred and account for creditors and payments made, as required by section 65(2)(b) of the MFMA.
49. The accounting officer did not take effective steps to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Human resource management

50. An acting municipal manager was appointed for a period of more than 12 months, in contravention of section 54A(2A)(a) of the MSA.

Procurement and contract management

51. Goods and services with a transaction value above R200 000 were procured without inviting competitive bids, as required by Supply Chain Management (SCM) Regulation 19(a). Deviations were approved by the accounting officer even though it was not impracticable to invite competitive bids, in contravention of SCM Regulation 36(1).
52. Contracts and quotations were awarded to bidders who did not submit declarations on whether they are employed by the state or connected to any person employed by the state, as required by SCM Regulation 13(c).
53. Awards were made to providers who are persons in the service of the municipality, in contravention of SCM Regulation 44.
54. Awards were made to providers who are persons in the service of other state institutions, in contravention of SCM Regulation 44.

Revenue management

55. A credit control and debt collection policy was not implemented, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of the MFMA.
56. An adequate management, accounting and information system was not in place to recognise revenue when it was earned and account for debtors, as required by section 64(2)(e) of the MFMA.

Conditional grant received

57. The allocations for the MIG and the integrated national electricity grant (INEG) were utilised for purposes other than those stipulated in the grant framework, in contravention of section 15(1) of DoRA.
58. The municipality did not submit quarterly performance reports to the transferring national officer, the relevant provincial treasury and the National Treasury within 30 days after the end of each quarter, as required by section 12(2)(c) of DoRA.

Strategic planning and performance

59. The municipality did not conduct its affairs in a manner that was consistent with its integrated development plan, as required by section 36 of the MSA and Municipal Planning and Performance Management Regulation 6.
60. The municipality did not take steps to improve performance with regard to those development priorities and objectives where performance targets were not met, as required by section 41 of the MSA.

Internal control

61. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for the disclaimer of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

62. The established code of conduct was not properly understood and adhered to by all employees.
63. Adequate and sufficient monitoring was not in place to ensure adherence to accounting and performance policies and procedures developed by the municipality, including the monitoring of the action plan.

Financial and performance management

64. The municipality did not have a proper record classification system that provided for the maintenance of information supporting the reported performance contained in the annual performance report.
65. A lack of training and understanding the accounting system resulted in material errors and challenges in linking the information reported in the financial system to the source.

Governance

66. The municipality conducted a risk assessment as required by the MFMA, but the action plan was not implemented and monitored.
67. The audit committee did not perform the functions of the performance audit committee as prescribed, resulting in material deviations in the annual performance report.

OTHER REPORTS

Investigations

68. An investigation is being conducted by the South African Police Service into a fraud case identified by the municipality against an invalid supplier. The investigation was still ongoing at the reporting date.
69. An investigation is being conducted by the Hawks into a fraud case against a supplier and the municipality relating to land acquisition. The investigation was still ongoing at the reporting date.

AUDITOR - GENERAL

Nelspruit

30 November 2012



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence